The Deputy Director of Central Intelligence

Washington, D.C. 20505

Executive Registry
85- 2799/1

26 July 1985

The Honorable Caspar W. Weinberger
The Secretary of Defense
Washington, D.C. 20301

Dear Mr. Secretary:

Relative to your question on U.S. oil import tariff, you may find this a useful brief on the subject.

Sincerely,

STAT

John N. McMahon

Enclosure:
Implications of a $5 per Barrel
US Oil Import Tariff

DCI
EXEC
REG

A-115

The Director of Central Intelligence

Washington, D.C. 20505

Executive Registry

85-2799

23 July 1985

The Honorable Donald T. Regan
Chief of Staff and Assistant to
the President
The White House
Washington, D.C. 20500

Dear Don,

Here's that analysis you asked for on Friday. As you see, it was done quickly and treats a wide range of implications, some of which might not be entirely relevant to your immediate concern.

If there are questions you would like more specifically focussed on, please give me a call and we'll get right to it.

Yours

[redacted]

William J. Casey

STAT

Enclosure:
Implications of a $5 per Barrel
US Oil Import Tariff

Orig w/Encl - Mr. Regan
1 w/o - DCI
1 w/Encl - DDCI then ER File

DCI EXEC REG

C-115

IMPLICATIONS OF A $5 PER BARREL US OIL IMPORT TARIFF

22 July 1985

STAT

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KEY FINDINGS

ALTHOUGH APPROXIMATELY $10 BILLION IN NEW REVENUES WOULD BE RAISED, **THE TARIFF WOULD NOT HAVE MAJOR US BUDGETARY OR ECONOMIC IMPACTS** EXCEPT AS PART OF A BROADER PROGRAM.

- o US OIL DEMAND WOULD FALL, INCREASING DOWNWARD PRICE PRESSURE IN THE INTERNATIONAL OIL MARKET. TO THE EXTENT OIL IMPORTS DECLINED AS A RESULT, THE REVENUE IMPACT WOULD BE LOWERED.

- o US GROWTH WOULD BE SLOWED, INFLATION INCREASED MARGINALLY AND THE TRADE DEFICIT REDUCED. US INTERNATIONAL COMPETITIVENESS WOULD BE IMPAIRED IN ENERGY INTENSIVE INDUSTRIES UNLESS THE DOLLAR FELL AS A RESULT OF THE TARIFF.

FOREIGN IMPACTS AND REACTIONS WOULD BE MIXED. IF GLOBAL OIL PRICES DECLINE BECAUSE OF THE IMPACT OF THE TARIFF ON US DEMAND, OTHER OIL-IMPORTING INDUSTRIAL COUNTRIES AND LDCS SUCH AS BRAZIL AND SOUTH KOREA WOULD BENEFIT; CONSEQUENTLY, THEY WOULD LIKELY REACT POSITIVELY IF THE TARIFF WERE PROMOTED AS A DEFICIT-REDUCING MEASURE AND APPLIED ON ALL OIL IMPORTS.

OIL EXPORTERS, ON THE OTHER HAND, WOULD BE HARMED--ALTHOUGH NOT GREATLY--AND **LIKELY WOULD REACT QUITE NEGATIVELY.**

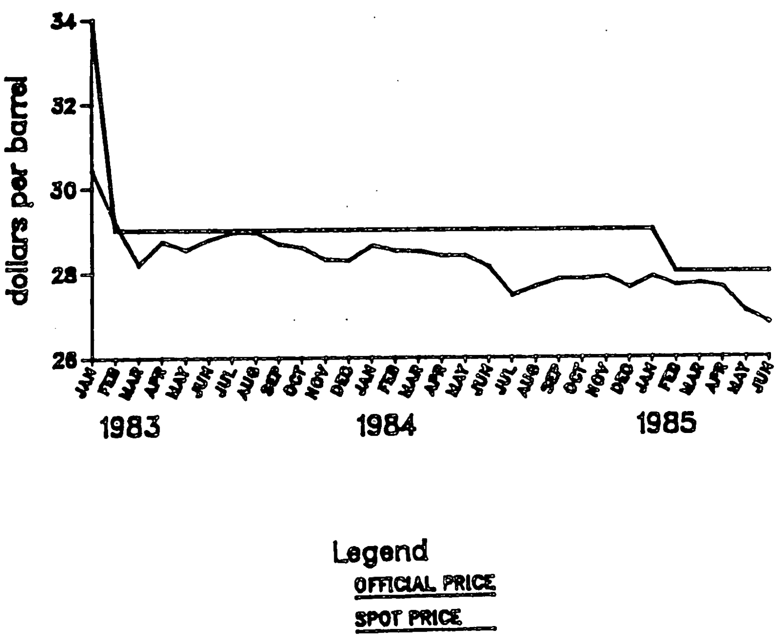
- o OPEC WOULD UNIVERSALLY CONDEMN AN OIL IMPORT TARIFF, ESPECIALLY IF IT CAME TO BE VIEWED AS AN ATTEMPT TO DESTROY THE ALREADY WEAKENED ORGANIZATION. THE ACTION MIGHT EVEN RALLY CONSENSUS FOR A NEW PRODUCTION QUOTA TO SHORE UP PRICES.

STAT

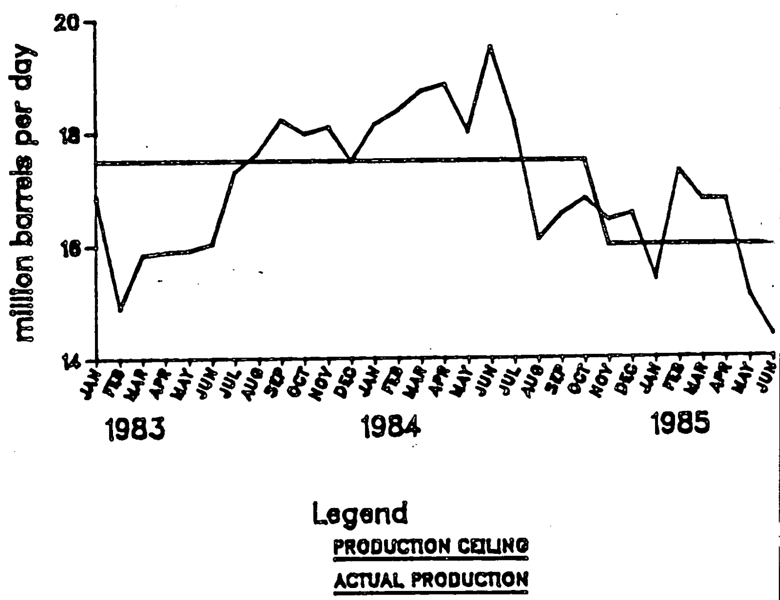
- o BECAUSE ADDITIONAL DOWNWARD PRESSURES ON OIL PRICES WOULD INTENSIFY MEXICO'S SEVERE FINANCIAL PROBLEMS, THE DE LA MADRID GOVERNMENT WOULD ALMOST CERTAINLY LODGE A STRONG PROTEST.

OPEC: PRICE AND PRODUCTION TRENDS

ARAB LIGHT CRUDE PRICES



OPEC: ACTUAL CRUDE OIL PRODUCTION VERSUS PRODUCTION CEILING



OIL MARKET REACTION

A $5 PER BARREL TARIFF WOULD PARTIALLY OFFSET SOME OF THE DECLINE IN NOMINAL OIL PRICES BY RAISING US ENERGY PRICES.

- o DOMESTIC CRUDE PRICES WOULD INCREASE SOMEWHAT AS THE MARKET MOVES TOWARD THE HIGHER PRICE OF IMPORTED OIL.

- o US OIL PRODUCT PRICES ON AVERAGE COULD RISE BY AS MUCH AS 12 CENTS PER GALLON. PRICE INCREASES WOULD DIFFER AMONG VARIOUS OIL PRODUCTS. GASOLINE PRICES PROBABLY WOULD RISE THE MOST BECAUSE READY SUBSTITUTES ARE UNAVAILABLE. THE SOFT ENERGY MARKET SHOULD MODERATE PRICE INCREASES FOR OTHER OIL PRODUCTS SINCE OTHER ENERGY PRODUCERS HAVE EXCESS CAPACITY TO COMPETE FOR MARKET SHARE.

- o OTHER ENERGY PRICES WILL ALSO LIKELY RISE BUT PROBABLY LESS THAN OIL AS SELLERS ATTEMPT TO GAIN MARKET SHARE.

- o DOMESTIC REFINERS RELIANT ON IMPORTS WOULD SUFFER THE SHARPEST COST INCREASE.

THE IMPACT ON US OIL DEMAND AND SUPPLY IN THE FIRST YEAR WOULD BE SMALL. US CONSUMPTION AND SUPPLY ARE EXPECTED TO APPROXIMATE 15.6 AND 11.1 MILLION BARRELS PER DAY (B/D) RESPECTIVELY IN 1985.

- o US OIL IMPORTS PROBABLY WILL APPROXIMATE 5.2 MILLION B/D IN 1985, INCLUDING CRUDE IMPORTS OF 3.4 MILLION B/D AND 1.8 MILLION B/D OF PETROLEUM PRODUCTS. US NORMALLY EXPORTS ABOUT 700,000 B/D. IMPORT REQUIREMENTS WOULD DROP BY AS MUCH AS 400,000 B/D IN RESPONSE TO A TARIFF AS HIGHER PRICES REDUCED DEMAND AND COMPANIES CUTBACK EXPORTS.

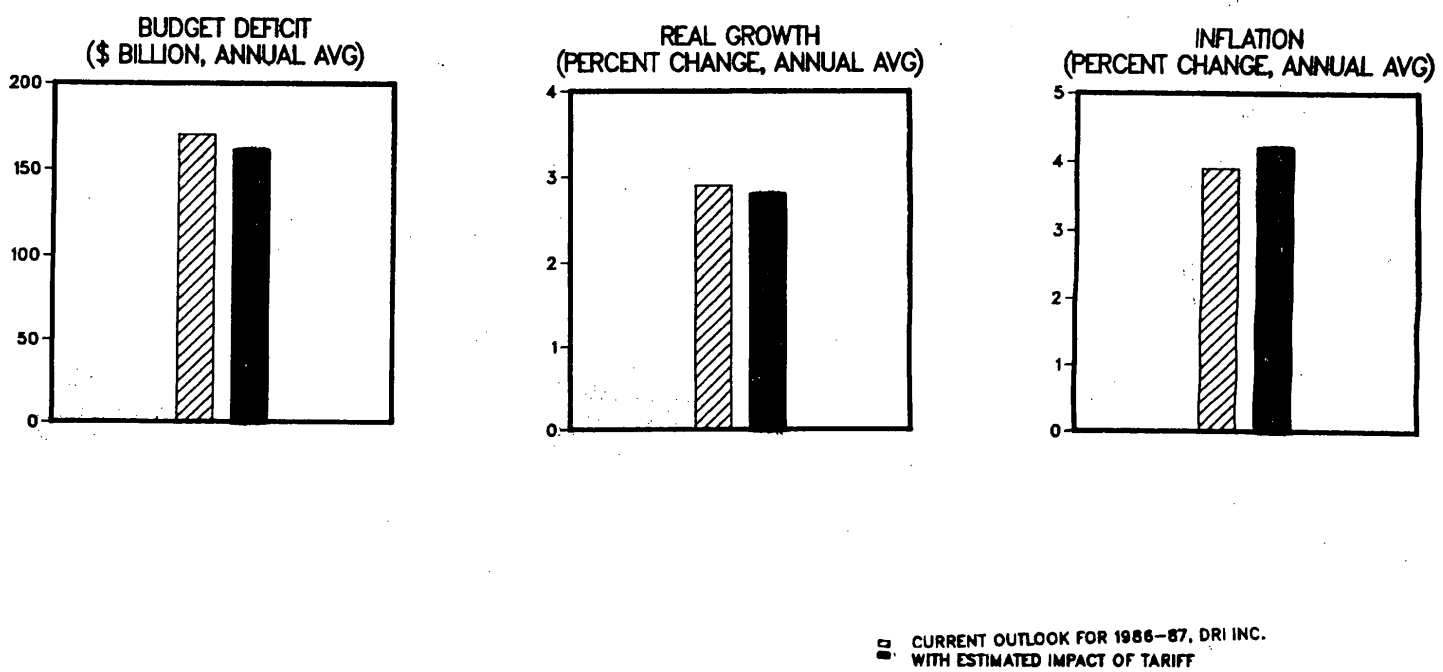
- o OVER THE LONGER RUN, HIGHER PRICES WOULD HAVE A MORE SIZEABLE DEMAND IMPACT AND WOULD ALSO HELP MAINTAIN HIGH US PRODUCTION LEVELS.

- o REDUCED RELIANCE ON IMPORTS AND INCREASED ATTRACTIVENESS OF INVESTMENTS IN THE US DOMESTIC OIL INDUSTRY WOULD ENHANCE ENERGY SECURITY.

PROSPECTS OF WEAKER US OIL DEMAND GROWTH WOULD INCREASE DOWNWARD PRESSURE ON INTERNATIONAL OIL PRICES.

- o WEAK OIL DEMAND, RISING NON-OPEC SUPPLIES AND SUBSTANTIAL EXCESS PRODUCTION CAPACITY WILL LIKELY CAUSE A FURTHER EROSION IN OIL PRICES OVER THE NEXT EIGHTEEN MONTHS. THE AVERAGE OFFICIAL OPEC OIL PRICE IS NOW $28 PER BARREL, $6 BELOW THE 1981 LEVEL.

US ECONOMY:
IMPACT OF $5/BARREL OIL IMPORT TARIFF



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US ECONOMIC IMPACT

A $5 PER BARREL TARIFF ON US OIL IMPORTS WOULD, IN OUR JUDGMENT, **HAVE ONLY MINIMAL IMPACTS** ON THE US ECONOMY, CHIEFLY BECAUSE SUCH A TARIFF WOULD SHIFT ONLY ABOUT $10 BILLION--OR 0.3 PERCENT OF US GNP--OUT OF THE HANDS OF CONSUMERS AND BUSINESSES. IF THE TARIFF ACCENTUATED THE DOWNWARD PRESSURE ON WORLD OIL PRICES AS WE EXPECT, THEN THE IMPACT ON THE US ECONOMY WOULD BE FURTHER MINIMIZED; THE MAXIMUM IMPACT WOULD OCCUR IF SUCH A TARIFF PRODUCED NO ADDITIONAL DROP IN OIL PRICES.

- **THE BUDGET DEFICIT WOULD BE DECREASED** BY ABOUT $10 BILLION ANNUALLY. IN ADDITION, REVENUE FROM THE WINDFALL PROFITS TAX WOULD PROBABLY AUGMENT THE GAIN.

- **REAL GNP GROWTH WOULD DROP** BY LESS THAN A QUARTER PERCENTAGE POINT. TO THE EXTENT THE FAVORABLE IMPACT OF THE TARIFF ON THE BUDGET DEFICIT LOWERED INTEREST RATES, THE IMPACT ON GNP WOULD BE LESS. ON BALANCE, HOWEVER, WE BELIEVE THE TARIFF WOULD SLIGHTLY DEPRESS US GROWTH.

- **INFLATION WOULD BE BOOSTED** BY ABOUT THE SAME SMALL AMOUNT GROWTH WOULD BE CUT. THE TARIFF'S MAXIMUM IMPACT WOULD ADD ABOUT THREE-TENTHS OF A PERCENT TO US INFLATION, INCLUDING ABOUT 12 CENTS PER GALLON ON RETAIL PETROLEUM PRODUCT PRICES.

- **THE OIL TRADE DEFICIT WOULD BE REDUCED** BY ROUGHLY $4 BILLION AS THE RESULT OF THE FALLOFF IN US IMPORT DEMAND.

- TO THE EXTENT THE TARIFF RAISES US ENERGY PRICES, **THE ENERGY PORTFOLIOS OF US BANKS WOULD ALSO BE STRENGTHENED.**

OTHER MORE INDIRECT AND LESS CERTAIN IMPACTS OF AN OIL IMPORT TARIFF RELATE TO THE VALUE OF THE DOLLAR AND US COMPETITIVENESS. THE INTERACTIONS HERE ARE COMPLEX. IF A TARIFF ON US OIL IMPORTS CAUSES FURTHER EROSION IN THE DOLLAR, US INTERNATIONAL COMPETITIVENESS WOULD BE ENHANCED; IF NO DOLLAR DECLINE RESULTED, THE IMPACT OF THE TAX ON US BUSINESS COSTS WOULD MARGINALLY WORSEN US COMPETITIVENESS IN ENERGY INTENSIVE INDUSTRIES.

Selected Foreign Economies: International Economic Linkages

	Oil Trade as Share of GNP (percent)	Exports to United States as Share of Total Exports (percent)
Oil Importers		
Western Europe	4	10
Japan	4	35
South Korea	7	35
Brazil	3	29
Argentina	negl	12
Oil Exporters		
Canada	8	73
Mexico	9	57
Venezuela	26	48
Nigeria	14	20
Saudi Arabia	36	10

Selected LDCs: External Debt

	External Debt ($ bil)	Portion of International Debt at Floating Interest Rates (percent)
South Korea	48	65
Brazil	105	82
Argentina	46	76
Mexico	101	87
Venezuela	33	93
Nigeria	21	78

FOREIGN ECONOMIC IMPACT

OUTSIDE OF THE US, THE POTENTIAL IMPACTS OF A TARIFF RANGE FROM MILDLY FAVORABLE TO MILDLY UNFAVORABLE. COUNTRIES THAT STAND TO GAIN ARE THOSE THAT: IMPORT OIL; ARE NOT CLOSELY LINKED TO THE US ECONOMY; PRICE EXPORTS IN DOLLARS; AND HAVE DEBT WHOSE INTEREST CHARGES ARE TIED TO US INTEREST RATES.

IN ALL CASES THE BENEFITS ARE CONTINGENT UPON THE TAX FORCING DOWN GLOBAL OIL PRICES. IN PARTICULAR:

- **WESTERN EUROPE** SHOULD BE BENEFITTED BY LOWER IMPORTED OIL PRICES THAT WOULD RESULT IF DOLLAR PRICES FELL; A DOLLAR DECLINE WOULD ACCENTUATE THIS BENEFIT.

- **JAPAN AND OTHER EAST ASIAN COUNTRIES** ALSO WOULD BENEFIT FROM LOWER OIL PRICES, BUT WOULD FEEL THE IMPACT OF ANY US ECONOMIC SLOWDOWN MORE HEAVILY BECAUSE OF STRONGER ORIENTATION OF THEIR EXPORTS TO THE US MARKET.

- **OIL-IMPORTING DEBTORS IN SOUTH AMERICA**--NOTABLY BRAZIL--ALSO WOULD POTENTIALLY GAIN FROM THE SIDE EFFECTS OF A US OIL IMPORT LEVY, PARTICULARLY IF INTEREST RATES DECLINED AS A RESULT.

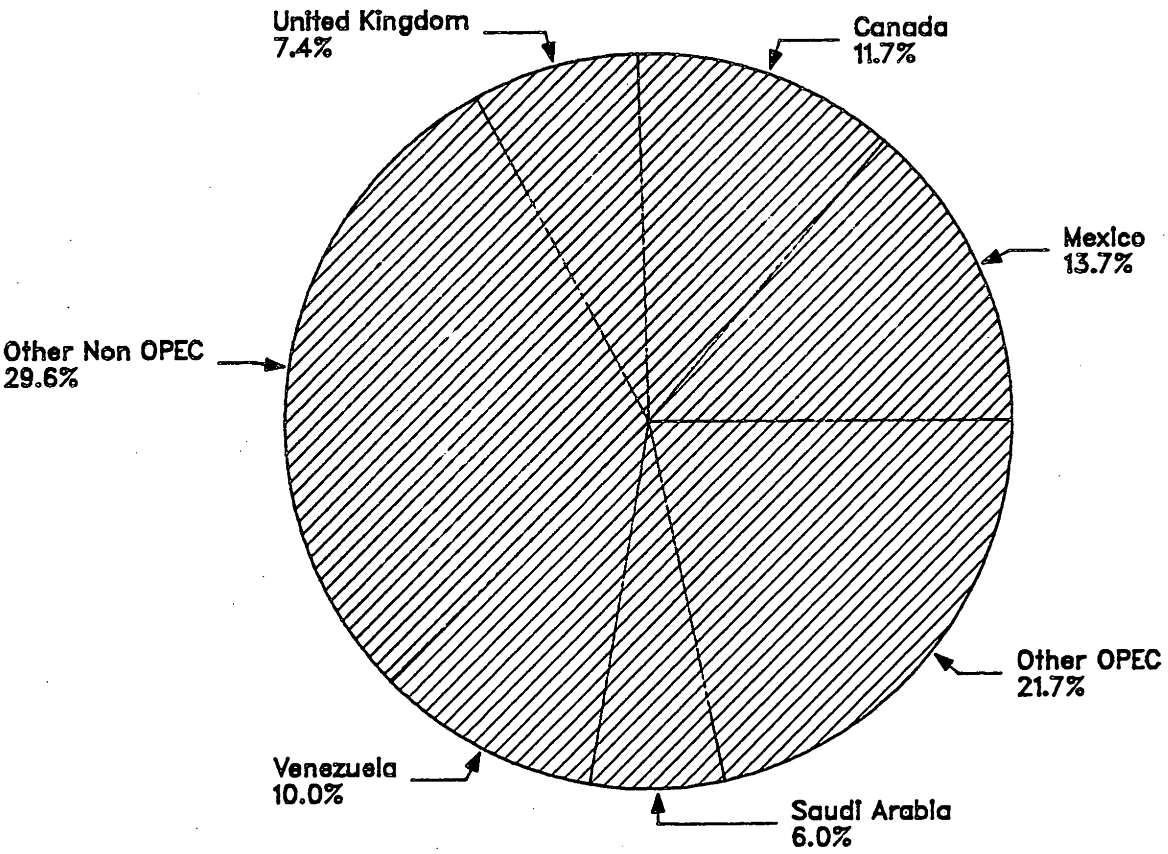
AT THE OTHER EXTREME, **OIL-EXPORTING COUNTRIES** STAND TO LOSE THE MOST FROM A US OIL IMPORT LEVY. THE EXTENT OF THEIR LOSS WILL DEPEND ON THE EXTENT TO WHICH THE TAX FURTHER DEPRESSES OIL PRICES; IF THERE IS NO PRICE EFFECT, THEY WOULD LOSE LITTLE WITH MOST OF THE BURDEN BEING BORNE BY US CONSUMERS AND BUSINESSES. IF, ON THE OTHER HAND, SUPPLIERS ARE FORCED TO CUT PRICES BY THE FULL AMOUNT OF THE TARIFF, THEY COULD LOSE UP TO $10 BILLION IN REVENUE--SOME 5-7 PERCENT OF THEIR OIL EARNINGS.

EXPORTERS LEAST WILLING TO LET PRICES DROP--NOTABLY SAUDI ARABIA AND OTHER MIDDLE EAST PRODUCERS--WOULD BE MOST AFFECTED. THE LOWER OIL REVENUES COULD INCREASE CHANCES OF DOMESTIC INSTABILITY IN THE STRATEGICALLY IMPORTANT PERSIAN GULF AREA. MEXICO, BECAUSE OF ITS DEPENDENCE ON THE US MARKET, ALSO COULD BE STRONGLY AFFECTED. WHILE CREATING MORE DIFFICULTIES FOR MANY OF THE ALREADY HARD-PRESSED OIL-EXPORTING COUNTRIES, WE DO NOT BELIEVE THE IMPACT OF THE TARIFF IN AND OF ITSELF WOULD DRAMATICALLY WORSEN THEIR SITUATIONS.

US Oil Imports — 1984

Total Imports 5.4 Million b/d

Total US Consumption 15.7 Million b/d



UNCLASSIFIED

FOREIGN REACTION

REACTION OF MOST MAJOR OIL EXPORTERS PROBABLY WILL BE NEGATIVE. KEY US SUPPLIERS GENERALLY HAVE PRICED THEIR OIL TO MAINTAIN MARKET SHARE AND WE WOULD EXPECT THIS POLICY TO CONTINUE:

- **MEXICO.** ADDITIONAL DOWNWARD PRESSURE ON OIL PRICES WOULD INTENSIFY MEXICO CITY'S ALREADY SEVERE FINANCIAL PROBLEMS. IT COULD NOT ABANDON THE US MARKET BUT THE DE LA MADRID GOVERNMENT WOULD STRONGLY PROTEST AND LIKELY WOULD ATTEMPT TO USE ITS US-OWED DEBT AS LEVERAGE.

STAT

- **VENEZUELA.** THE EXISTENCE OF A BILATERAL TRADE AGREEMENT WITH VENEZUELA PROHIBITS SUCH A TARIFF ON THEIR OIL PRODUCT EXPORTS TO THE US. THIS AGREEMENT WOULD PROVIDE A NATURAL FOCUS FOR ANY PROTEST.

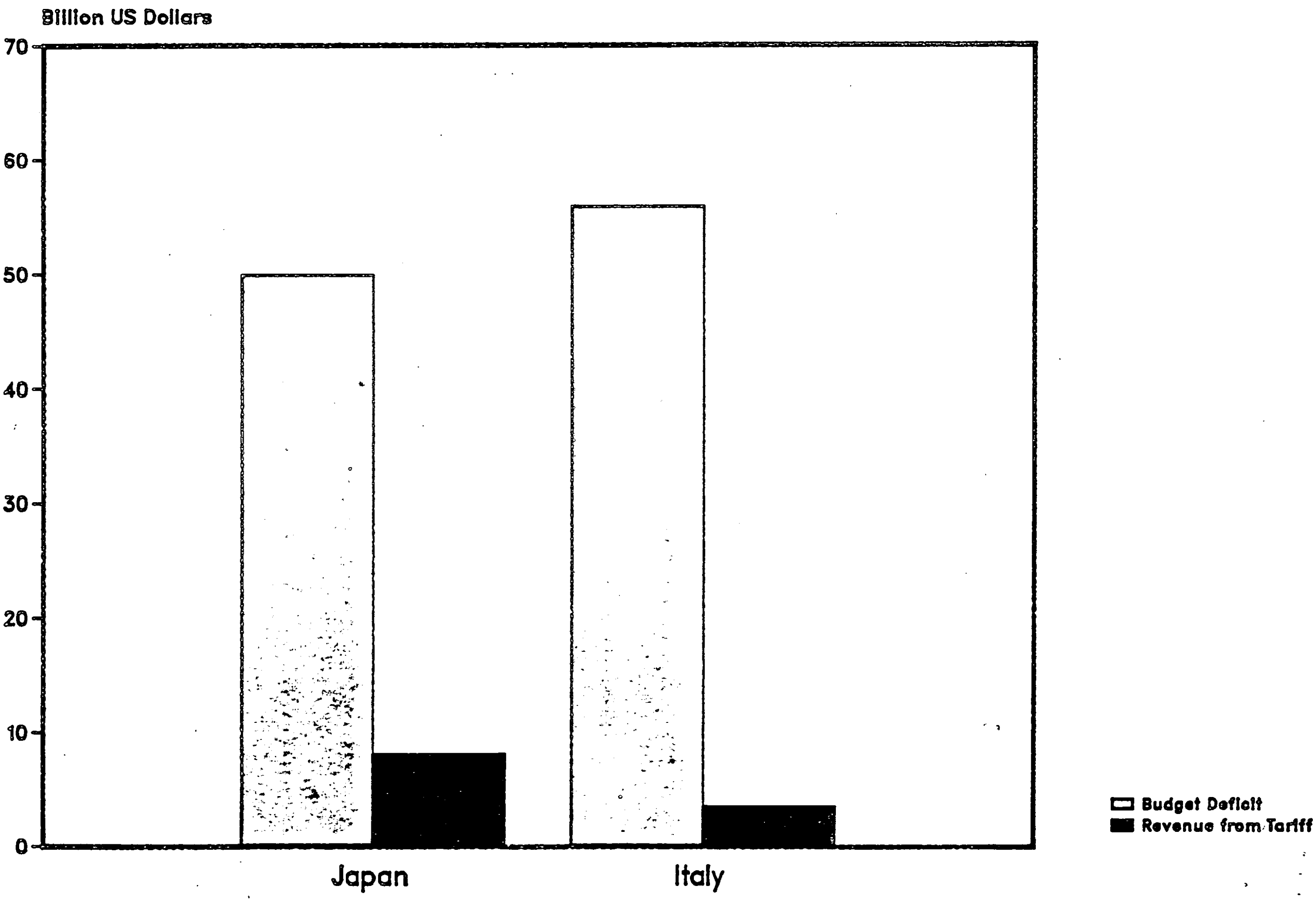
- **UNITED KINGDOM.** RELATIVE PROXIMITY TO US EAST COAST MARKET LIKELY WOULD MEAN LITTLE OR NO EROSION IN MARKET SHARE AS LONG AS UK REMAINS PRICE COMPETITIVE.

- **OPEC.** AN IMPORT TARIFF WOULD BE UNIVERSALLY CONDEMNED BY OPEC MEMBERS. THE ACTION COULD RALLY CONSENSUS FOR NEW PRODUCTION QUOTAS, BUT OVERALL MARKET WEAKNESS WOULD ULTIMATELY MAKE THIS ATTEMPT SHORT-LIVED.

- **SOVIET UNION.** MOSCOW, WHICH WOULD LOSE FOREIGN EXCHANGE EARNINGS FROM OIL AND GAS SALES TO THE WEST AS OIL PRICES FALL, MIGHT TRY TO REAP SOME POLITICAL BENEFITS WITH THIRD WORLD OIL EXPORTERS BY BLAMING THE US FOR THE OIL PRICE DECLINE.

REACTION FROM MAJOR CONSUMING ALLIES WOULD BE POSITIVE IF MOVE WAS VIEWED AS HAVING A SIZEABLE IMPACT ON THE BUDGET DEFICIT, AS LONG AS TARIFF WAS IMPOSED ON ALL OIL IMPORTS.

Selected OECD Countries — 1986
(Potential Gains From a $5 per Barrel Oil Import Tariff)



IMPLEMENTATION

WHILE THE US WOULD NOT VIOLATE ITS GATT OBLIGATIONS BY INSTITUTING A TARIFF ON CRUDE AND PRODUCTS, SEVERAL PREPARATORY ACTIONS SHOULD BE CONSIDERED:

- o CONSULTATIONS WITH OUR ALLIES AND MAJOR OIL PRODUCERS IN ADVANCE TO EMPHASIZE THE REVENUE RAISING/DEFICIT REDUCTION NATURE OF THE TARIFF. THIS COULD HELP OFFSET NEGATIVE POLITICAL RAMIFICATIONS AND MIGHT ALSO PRECLUDE OPEC FROM COALESCING BEHIND THIS ISSUE.

- o APPLYING THE TARIFF GRADUALLY AS OIL PRICES FALL, TO PREVENT CONSUMER PRICES FROM RISING. THIS COULD HELP AVOID CONSUMER OPPOSITION TO THE MEASURE. INDEED, IF THE TARIFF ONLY PARTIALLY OFFSET THE FALL IN OIL PRICES, SOME OF THE ECONOMIC BENEFITS OF LOWER OIL PRICES COULD STILL BE PASSED ON TO CONSUMERS AT THE SAME TIME THE GOVERNMENT WAS INCREASING ITS TARIFF REVENUES.

- o A TARIFF SHOULD BE ON ALL OIL IMPORTS--CRUDE AND PETROLEUM PRODUCTS. A TARIFF ON CRUDE OIL ALONE WOULD ENCOURAGE AN INFLOW OF REFINED PRODUCT. A TARIFF ON PRODUCTS WOULD ENCOURAGE CRUDE OIL IMPORTS AND VIOLATE THE RECENT INTERNATIONAL ENERGY AGENCY MINISTERIAL COMMITMENT ON OIL PRODUCTS TRADE.

- o ENCOURAGE ALLIES--ESPECIALLY THOSE WITH LARGE BUDGET DEFICITS LIKE JAPAN AND ITALY--TO APPLY SIMILAR TARIFFS, BOTH TO HELP MAINTAIN US INDUSTRIAL COMPETITIVENESS IN ENERGY INTENSIVE INDUSTRIES AND TO PROMOTE OECD ENERGY SECURITY.